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IN THE

SUPREME COURT OF THE UNITED STATES.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,
vs.
GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court of Appeals
for the Eighth Circuit.

REPLY BRIEF FOR THE PETITIONER.

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Reply to Respondent's Statement.

Respondent's assertion (Br. 3) that on August 1, 1949, the sixteen corporations were "dissolved" is not supported by the Record and is contrary to the fact. The corporations were merged but not dissolved (R. 15).

The assertion (Br. 3) that in the year ended July 31, 1950, each of the "businesses" formerly operated by the three corporations with losses continued to sustain a loss is not accurate. The fact is that the **locations** formerly operated by the three corporations as separate businesses continued to sustain losses when operated by petitioner as parts of a unified business (Cf. Pet. Br. 24, 34; R. 17).

Reply to Respondent's Argument.

1. **The Argument Under the Statute.**

The Government argues, first, that under Sections 23 (s) and 122 of the 1939 Code the deduction in question is available only to the taxpayer who sustained the loss (Br. 9-19). In support of this argument the Government cites the language of Section 122 (b) (2) (C), reasoning as follows:

(i) The statute permits a loss carry-over "'if . . . the taxpayer' sustained the loss.'"

(ii) "Thus the only 'taxpayer' authorized to carry over a loss . . . is 'the' taxpayer who had the loss" (Br. 11).

In view of the words omitted from the quotation in (i) above, the Government's reasoning is an obvious non sequitur. The statute says: **"If for any taxable year beginning after December 31, 1947, and before January 1, 1950,** the taxpayer has a net operating loss. . . ." (Emphasis supplied.) Thus "the" taxpayer referred to is not the taxpayer claiming a carry-over, but the taxpayer with respect to any given taxable year beginning between the prescribed dates, and all the statute goes on to say is that if such taxpayer has a loss, such loss **shall be** a carry-over for each of the three succeeding taxable years. It does not say for **whose** succeeding taxable years the loss shall be a carry-over.

The Government contends, moreover, that its conclusion from the language of Section 122 is confirmed by **New Colonial Ice Co. v. Helvering,** 292 U. S. 435, quoting from pages 440-441 (Br. 12). But, as the quoted portions of the opinion themselves reveal, Section 204 (b) of the 1921 Act there involved, unlike Section 122 here, explicitly identifies the taxpayer sustaining the loss as the taxpayer entitled to the deduction.

The Government, therefore, cannot find support for its first argument in the language of the statute.

The Government next points to the legislative history of the loss carry-over, in a further effort to show that the deduction is available only to the taxpayer who sustained the loss (Br. 13-16). In particular, it cites the 1939 Committee Report, H. Rep. No. 855, 9-10, as evidence of an intent limited to permitting a taxpayer with fluctuating business income to "average the income" over a period of years (Br. 15). But the quoted portion of the committee report merely notes that as "a" result of the 1932 repeal of the loss carry-over a business with alternating profit and loss suffered in comparison with a business with stable profits. This is not to say that this was the **only** result of the repeal, or consequently to imply that the only purpose of the re-enactment was to alleviate this condition. Obviously, the committee in this excerpt from its report is addressing itself to the simple case of carry-over uncomplicated by corporate reorganization.

Respondent would have us conclude from this that the carry-over was not intended to be allowed in any case of reorganization: "There was no intention . . . to permit the averaging of business income of different taxpayers" (Br. 15-16). Yet there can be no question that the statute by its very terms **does** permit the averaging of business income of different "taxpayers" (in the sense in which the Government understands that term) in the case, for example, where corporation A, with a history of profits, merges into corporation B, with a history of losses, and B subsequently offsets its earlier losses against profits derived from the assets acquired from A.

Congress must be assumed to have intended what it expressly permits. And Congress having intended to allow the deduction in the situation described, it is most unreasonable to attribute to Congress an intent to bar the carry-

over in the converse case, i. e., where, as here, the corporation having losses merges into the corporation having profits. Or, to adapt the language respondent quotes from the opinion of this Court in **Olympic Radio & Television**, 349 U. S. 232 (Br. 10-11), it may be that Congress granted **more** than some thought or more than was originally intended. "We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit." 349 U. S. 236.

2. **The "Not-the-Same-Taxpayer" Argument.**

The Government's second argument is that petitioner is not the same taxpayer as the three corporations with losses (Br. 19-28).

In support of this argument, the Government first invokes the doctrine of corporate entity. It is submitted that this is inapposite.

Petitioner's position (so far as relevant to the "same taxpayer" argument) is that as a result of the merger, the **separate** existence of each of the corporations thereupon ceased. Petitioner at all times thereafter **included** each of the merged corporations. Discussion of the doctrine of corporate entity is appropriate only to distinguish the identities of the several corporations while they retained their separate existences, i. e., prior to the merger, and to identify the petitioner as an entity apart from its stockholders thereafter. The doctrine is of no help in explaining the relationship between petitioner and the other corporations **after** the merger. This relationship can only be understood in terms of the concept of statutory merger, which in a sense replaces the doctrine of corporate entity as a medium of understanding the inter-corporate relationship at the point where the latter ceases to function for this purpose.

When this is understood, the points made by the Government lose all force and meaning.

Thus the filing of separate returns for the last periods of separate existence of the corporations in no way conflicts with petitioner's contention with respect to their relationship after the merger. (Cf. Brief for Resp. p. 20.)

Thus the invocation of the corporate entity doctrine in the **New Colonial** cases is attributable to the continued **separate** corporate existences following the reorganization, and is not a precedent for application of the doctrine here. To contend that the cases are alike because the transfer here was "likewise voluntary and contractual" (Brief for Resp., p. 23, n. 7) is to fly in the face of the following decisions: **Dodier Realty and Investment Co. v. St. Louis National Baseball Club,** 238 S. W. (2d) 321 (Mo. 1951); **Helvering v. Metropolitan Edison Co.,** 306 U. S. 522, 528 (1939); **U. S. v. Seattle-First National Bank,** 321 U. S. 583, 587-588 (1944).

The Government's analysis, having at first ignored the import of the merger under state statutes, continues by affirmatively dismissing the latter on the grounds that the state law (1) does not erase the "separate prior existences" of the corporations, (2) does not purport to authorize a deduction, and (3) could not effectively authorize a deduction (Br. 25-26).

All this is fine but immaterial, as petitioner does not contend that the corporations were not separate **prior** to the merger, nor that the state statutes authorize the deduction. The contention is that in considering whether the deduction is authorized by the federal tax statute, effect must be given to state law insofar as it determines the federal statute's terms of reference. This is not new. It is precisely what this Court did in **Helvering v. Metropolitan Edison Co.,** supra.

As a matter of fact, the Government is in no argumentary position to deny that state law must be given this limited effect. If state law cannot be invoked to deter-

mine the question of continuity of corporate existence upon merger, it cannot with any more reason be invoked to determine the question of corporate existence prior to or after merger, i. e., "corporate entity." In the absence of any consideration of state corporation law, we are forced to resolve the question of terminology under Section 122 within the confines of the Internal Revenue Code. Thus "taxpayer" means "person" subject to tax; "person" includes "corporation"; and "corporation" includes "associations." I. R. C. 1939, Section 3797 (a) (14), (1) and (3). There was but one "association" before and after the merger, and the losses of that association can be offset against its profits.

Of course, the straightforward answer is that the Internal Revenue Code itself adopts state laws of incorporation in the definition of "corporation." That word "includes," but is not limited to, associations. It has always been recognized to mean and include any organization activated under state laws (whether or not an association). The notion that state law can establish existence, but not continuance, entity but not identity, is a shadow which vanishes with light.

The Government next addresses itself directly to the concept of statutory merger, arguing that for purposes of the "taxpayer" question, a merger is indistinguishable from other types of reorganization (Br. 28-41).

The argument is framed in terms of objections to the decision in **Stanton Brewery v. Comm.**, 176 F. (2d) 573. The first objection, that the decision violates the corporate entity doctrine, repeats argument made earlier and has been answered, supra, pp. 4-5.

The second objection amplifies argument made earlier, adding that to give effect to local law with respect to merger would prevent uniform application of the federal statute. But a statutory merger is a standardized con-

cept, recognized as such in the Internal Revenue Code. The tax law has long provided that no gain or loss is recognized upon certain exchanges in connection with certain corporate reorganizations. Section 112 (b), I. R. C. 1939. The term "reorganization" is defined in the 1939 Code to include "a statutory merger or consolidation," without any elaboration of meaning. Section 112 (g). Similar provisions are contained in the 1954 Code, Sections 354, 361 and 368. Evidently Congress is sufficiently confident in the uniform effects of statutory mergers in the several states to permit the question of tax-free reorganization to turn upon whether or not there has been such a merger, without necessity for further inquiry. Moreover, it will be noted that Congress has followed the same pattern in Section 381 of the 1954 Code, where it expressly authorizes carry-overs in corporate reorganizations, including "a statutory merger or consolidation" [Section 368 (a) (1) (A)], without so much as defining that term.

The Government's third objection to **Stanton Brewery** and to application of the merger concept confuses the primary liability of a merger successor for its predecessor's taxes, with the derivative liability of a transferee under 1939 Code, Section 311. That a merger successor is also liable under that section does not detract from the significance of the distinction. The difference in the nature of the liability is sufficiently indicated by the Government's own reference to the liability under Section 311 as being limited "to the extent of the value of the property received by the transferee" (Br. 31, n. 15). Of course the liability of a surviving corporation in a statutory merger is not limited in this or in any other way.

3. **The "Not-The-Same-Business" Argument.**

The Government's third argument is that even if petitioner is regarded as "the same taxable entity" as each of the merged corporations, it is not entitled to the deduc-

tion claimed "since its business was not the same" (Br. 41-47).

In support of this argument, the Government first repeats its earlier reference to the legislative history discussed and answered under 1, above.

The Government next cites Section 382 (a) (1) (C) of the 1954 Code, as precluding a carry-over "even by the same corporation unless, among other things, the corporation continues to carry on 'substantially the same' business as before." Whether careless or bold, this is a misleading statement of the law.

The only case in which a change in a "trade or business" carried on by a corporation is significant under Section 382 (a) is the case where such change is accompanied by a substantial change in stock ownership of the corporation having a loss carry-over, **and then only where the latter change is incident to a purchase.** It is only in this combination of circumstances that a carry-over is precluded by the statute cited by the Government. I. R. C. 1954, Sec. 382 (a).

On the other hand, in a case of change of stock ownership incident to a "reorganization" including a statutory merger) as opposed to a purchase, this change **alone and without reference to any change in trade or business** is made significant by Section 382 (b), which provides for partial reduction of loss carry-overs in such a case. It will be noted that there was no such change in stock ownership in the instant case (R. 16).

Thus, far from detracting from petitioner's position, consideration of Section 382 of the 1954 Code in fact enhances it. What Congress in effect says in Section 382 (b) is that the presence of "reorganization" **itself** supplies the only continuity in the business sense which is requisite

to an inter-corporate carry-over, and that in such cases the only variable in the equation is continuity of stock ownership. This approach is entirely logical, for it is a corollary of the proposition that continuity of interest is an essential ingredient of tax-free reorganization. **Pinellas Ice & Cold Storage Co. v. Commissioner,** 287 U. S. 462 (1933); **LeTulle v. Schofield,** 308 U. S. 415 (1940).

CONCLUSION.

The arguments made by the Government in its brief do not require any change in petitioner's original conclusion that the judgment of the Court below should be reversed.

Respectfully submitted,

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